

Will Rising Interest Rates Burst the Housing Bubble?

Washington: Although Federal Reserve officials today announced the short-term federal funds rate will remain unchanged, their report makes it clear that the “policy accommodation” of promoting economic growth through exceedingly low interest rates is coming to an end. In other words, the Fed has signaled that it can and will increase interest rates in the near future. The current funds rate of 1%- the lowest in 45 years- results from years of aggressive Fed rate cutting. The incredible increase in American housing prices over the last ten years is directly attributable to this Fed easy credit policy, yet few Americans understand that housing prices are artificially high- and destined to fall significantly when interest rates rise.

During recent testimony by Mr. Greenspan before the Joint Economic committee, Congressman Ron Paul pressed the Chairman to acknowledge the potential severity of a collapse in housing prices. “I think the Fed is mistaking debt with collateral,” Paul stated at the hearing, referring to recent Greenspan statements touting home equity loans as the engine driving economic growth. “New debt is not wealth,” Paul added. Still, Chairman Greenspan continued to insist that Americans are richer because of paper increases in the value of their homes. Yet the very Fed policy responsible for higher demand and higher housing prices- cheap credit- is about to change.

“Federal Reserve manipulation of interest rates and the money supply has created a perilous situation for millions of Americans,” Paul stated. “Rising interest rates may well cause housing prices to fall dramatically, leaving many homeowners who bought at the height of the bubble owing more than their homes are worth. Homeowners with adjustable-rate mortgages are especially vulnerable, as are those who used paper gains in real estate values as collateral for second, third, and even fourth mortgages. The Fed’s easy-credit policies are directly responsible for lowering creditworthiness standards and encouraging millions of Americans to overextend themselves. If trillions of dollars in housing equity disappear, no amount of Fed sorcery will keep record amounts of Americans out of bankruptcy.”